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NOV 25 1941
CHARLES ELMORE CROPLEY
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IN THE

Supreme Court of the United States

October Term, 1941

NO. 760

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ESTATE OF JOHN SAGE, DECEASED, ALFRED D. SAGE, ROBERT J. RENDALL AND THE FIFTH AVENUE BANK OF NEW YORK, EXECUTORS, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No.

ESTATE OF JOHN SAGE, DECEASED, ALFRED D. SAGE, ROBERT J. RENDALL and THE FIFTH AVENUE BANK OF NEW YORK, Executors, Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

The petition of Alfred D. Sage, Robert J. Rendall and The Fifth Avenue Bank of New York, executors of the last will and testament of John Sage, deceased, respectfully shows:

The Question Presented

The only question involved is whether, in computing the federal estate tax, the amount deducted by the executors of

a decedent's last will and testament for charitable and public bequests must be reduced by a sum equivalent to the amount agreed to be paid by the residuary charitable beneficiary to or for the decedent's widow, under an agreement in settlement of a contest over the probate of the decedent's last will and testament.

Summary Statement of Matter Involved

This petition for a writ of certiorari seeks to review a decision of the Circuit Court of Appeals for the Third Circuit (R. 79, 87) affirming a decision of the Board of Tax Appeals (R. 40), which sustained the Commissioner's determination of a deficiency in federal estate tax in the sum of $9,687.66. The issue arises under Sec. 303 (a) (3) of the Revenue Act of 1926 (44 Stat. 72, 26 U.S.C.A. § 412), as amended. The stipulated facts (R. 48) are as follows:

Petitioners are the executors of the estate of John Sage, who died on October 11, 1936, testate, a resident of Bergen County, New Jersey. He left him surviving a widow, Dorothy T. Sage. On December 21, 1936, she was adjudged an incompetent, and thereafter guardians were appointed for her by the Bergen County Orphans' Court.

The decedent left an estate of approximately $450,000.00. Under his last will and testament (R. 51), his widow was bequeathed his household effects and legacies totaling $42,000.00. The residuary estate was bequeathed to the Lord Provost of Glasgow, Scotland, in manner following:

> "ELEVENTH: I direct my said executors to convert into cash all the rest, residue and remainder of my property of whatsoever kind, nature or description, and I give and bequeath the proceeds of such conversion to the LORD PROVOST of Glas-

gow, Scotland. I request said LORD PROVOST to distribute same among such institutions in Scotland, as are devoted to the care and maintenance of blind, maimed and disabled soldiers and sailors of the British Army and Navy, according to his best judgment and discretion."

The will was first offered for probate in New York, where its admission was contested by the widow. The New York proceedings were subsequently dismissed, and the will was offered for probate before the Surrogate of Bergen County, New Jersey, on April 9, 1937. On May 8, 1937, the widow's guardians entered into an agreement with the Lord Provost, through his attorney-in-fact (R. 55). In substance, this agreement provided that the widow, through her guardians, would withdraw all objections to probate and that the Lord Provost, as residuary legatee would pay to the widow a sum equivalent to 25% of the amount received by the residuary legatee under the provisions of the will (R. 35, 80). Petitioners, as executors, were not parties to this agreement. Thereafter, upon the petition of the guardians (R. 65), this agreement was approved by the Bergen County Orphans' Court (R. 73). The agreement was not, however, incorporated in, nor did it ever become a part of, the probate or other proceedings relating to the administration and distribution of the decedent's estate. Its approval was made necessary only because it concerned the acts of guardians in behalf of an incompetent.

Thereupon, all objections in behalf of the widow to the probate of the will were discontinued and it was admitted to probate on May 19, 1937. Petitioners thereupon qualified as executors and entered upon the administration of the estate.

On December 1, 1937, petitioners rendered their final account as executors to the Bergen County Orphans' Court. On January 11, 1938, the account was allowed (R. 74). The account showed a balance for distribution of $175,750.48, after the payment of debts, specific and general legacies and allowances, and the payment of all commissions, counsel fees and other administration expenses and disbursements. Thereafter, on February 9, 1938, a decree of distribution was entered, which awarded and distributed the entire balance on hand to the Lord Provost as residuary legatee. Neither this decree nor that allowing the account provided for any payment to the widow, or her guardians, other than to approve the earlier payment and delivery to her of the cash legacies of $42,000.00 and the decedent's household effects.

On March 30, 1938, the attorney-in-fact for the Lord Provost, pursuant to the terms of the compromise agreement, paid the sum of $33,687.62 to the widow's guardians and, at the time of the stipulation before the Board of Tax Appeals, had in his possession the further sum of $5,000.00 to be paid to the widow's guardians.

On September 20, 1937, petitioners filed a federal estate tax return in which deduction was claimed for the full amount of the residuary estate as a charitable and public bequest. On January 5, 1939, the Commissioner determined a deficiency in tax, having disallowed one-fourth of the deduction claimed for the residuary bequest on the ground that, under the terms of the compromise agreement, the amount paid the widow by the Lord Provost passed to her, as the widow, in settlement of her contest of the will, and that , in no event, could the payment to the widow be considered part of a charitable bequest entitled to freedom from estate tax. The State of New Jersey had previously assessed the decedent's estate for

transfer inheritance taxes on the basis that the entire residuary estate was a charitable and public bequest.

It has been conceded throughout that the residuary bequest was to a charitable use. It is only the amount which may be deducted in determining the net estate subject to tax which is in dispute. It has been further admitted throughout that neither petitioners, the charitable beneficiary nor the widow's guardians entered into the agreement in question to evade, or to affect in any way, the tax liability of the estate, the agreement having been consummated prior to the decisions in any of the cases discussed by the tribunals below.

The Circuit Court of Appeals, in affirming the decision of the Board of Tax Appeals, held as follows:

1. The widow took from the estate that which she received under the compromise agreement, not by testacy or intestacy, but by a novel category of succession which the court called "inheritance". The principles of the income tax case of *Lyeth* v. *Hoey*, 305 U. S. 188, were applied to the situation.

2. The decision in the similar case of *Robbins* v. *Commissioner*, 111 Fed. (2d) 828 (C. C. A. 1st), relied upon by petitioners, was not followed. The reasoning of the *Robbins* opinion that the *Lyeth Case* is not applicable to estate tax problems and that taxability must be determined by the situation existing at the date of death was ignored and inferentially disapproved.

3. Sec. 303 (a) (3) of the statute must be read to mean that the deduction, in the case of a bequest to a trustee for a charitable use, is measured by the amount which the charity actually receives and uses for charitable purposes and not by what the testator provided.

4. Sec. 303 (a) (3) of the statute must be read to mean that some part, or all, of a deductible charitable bequest

may be rendered taxable by the acts of persons, other than the executor, in settling a will contest subsequent to death and irrespective of the testator's expressed intentions.

The opinion of the Board of Tax Appeals is reported in 42 B. T. A. 1304 (R. 33) and that of the Circuit Court of Appeals in 122 Fed. (2d) 480 (R. 79).

Jurisdiction

The judgment of the Circuit Court of Appeals was entered June 27, 1941 (R. 87). On September 18, 1941, this Court extended the time within which petitioners could file a petition for a writ of certiorari to November 26, 1941 (R. 89).

Jurisdiction to issue the writ is found in the provisions of Sec. 240 (a) of the Judicial Code, as amended, (43 Stat. 938, 28 U. S. C. A. § 347).

Reasons Relied upon for Allowance of the Writ of Certiorari

A writ of certiorari should be allowed because:

1. This case presents a novel, substantial and important federal tax question relating to the construction of Sec. 303 (a) (3) of the Revenue Act of 1926, as amended, which has never been passed upon by this Court. An early authoritative decision by this Court of this question, to wit: whether, in computing the federal estate tax, the amount of the deduction for a charitable and public bequest must be reduced by a sum equivalent to the amount paid, or agreed to be paid, by the charitable beneficiary to a decedent's widow, or other "heirs", under an agreement in settlement of a probate contest, is of pressing

importance, not only to the parties to this cause, but also to all persons whose estates may be subject to federal estate taxes and those who may be required to administer such estates as executors. The precise question has been before the Commissioner on numerous occasions and has just again been decided adversely to the executor, on the basis of this case, by the Circuit Court of Appeals for the Second Circuit in *Thompson* v. *Commissioner* (No. 39, October Term, 1941, decided November 17, 1941 and not yet reported), a case involving a deficiency assessment of more than $120,000.00 and in which, petitioners are informed, application will be made to this Court for a writ of certiorari.

2. Aside from the novelty and importance of the issue presented, the decision below is erroneous and not in accord with the principles of the following decisions of this Court, to wit: *United States* v. *Provident Trust Co.*, 291 U. S. 272; *Edwards* v. *Slocum*, 264 U. S. 61; *Y. M. C. A.* v. *Davis*, 264 U. S. 47; *New York Trust Company* v. *Eisner*, 256 U. S. 345, 348, 349, and *Knowlton* v. *Moore*, 178 U. S. 41, 49, in that it disregards the fundamental rules laid down therein that (a) the federal estate tax is one on transmission and not on succession, (b) is governed by the situation existing at the testator's death and (c) is controlled by what he did in his will, in the absence of a statutory exception thereto. No exception concerning amounts paid, or agreed to be paid, by charitable beneficiaries in settlements of probate contests effected subsequent to the testator's death is found in Sec. 303 (a), nor was relied upon by the court below.

3. The decision below is in conflict with the reasoning of the Circuit Court of Appeals for the First Circuit in *Robbins* v. *Commissioner*, 111 Fed. (2d) 828, where it was held, in a case involving a similar estate tax prob-

lem, that the rationale of *Lyeth* v. *Hoey, supra,* is not applicable to estate tax cases and that deductions for charitable bequests must be determined by the situation existing at the date of death. This irreconcilable state of the reasoning in the authorities on the question of the construction of Sec. 303 (a) (3) aforesaid, in the absence of a clarifying adjudication by this Court, leaves the law in uncertainty.

4. The court below erred in basing its decision upon the income tax case of *Lyeth* v. *Hoey, supra,* in that it held that the widow took the amount of her compromise, not by testacy or intestacy, but by "inheritance", a term not found in the applicable provisions of the estate tax law as it is in Sec. 22 (b) (3) of the Revenue Act of 1932 dealing with certain exemptions from income tax. This is a clear misapplication of the principle of the *Lyeth Case.* The broad language used in the *Lyeth* opinion has resulted, as here, in confusion and unsound application and should be limited by this Court to the facts and statute there involved.

5. The court below, in its construction of Sec. 303 (a) (3) on a phase never passed upon by this Court, erred in holding that that section must be read to mean (a) that the amount deductible is the amount actually received and used by the charitable beneficiary for charitable uses, irrespective of the provisions of the testator's will and of agreements made in settlement of will contests to which the executors are not parties and of which they may not even have knowledge; (b) that where such charitable beneficiary is a trustee, as distinct from a charitable corporation, the section imposes a stricter test of deductibility; and (c) that Art. 47 of Treasury Regulations 80 concerning conditional charitable bequests is applicable despite its clear language to the contrary.

6. The court below, in its construction of Sec. 303 (a) (3), invaded the Congressional field of legislation, since the statute is entirely silent on the question of any exception to deductibility where the charitable beneficiary pays, or agrees to pay, a sum in settlement of a will contest. Congress not having covered the situation and there being no reasonable basis of interpretation to be derived from the legislation to cover it, the statute must be construed liberally in favor of the taxpayer and the deduction allowed in the full amount of the charitable bequest as made by the testator.

WHEREFORE, your petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, commanding that court to certify and to send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings therein; and that the said judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed by this Honorable Court, and that your petitioners may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

T. Girard Wharton,
Counsel for Petitioners.

Dated November 24, 1941.

BRIEF IN SUPPORT OF PETITION

I

Statute Involved

Section 303 (a) (3) of the Revenue Act of 1926 (44 Stat. 72, 26 U. S. C. A. § 412), as amended, reads as follows:

> "For the purpose of the tax the value of the net estate shall be determined—
>
> "(a) In the case of a citizen or resident of the United States, by deducting from the value of the gross estate—
>
> * * * * * * * * *
>
> "(3) The amount of all bequests, legacies, devises, or transfers, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation, or to a trustee or trustees, or a fraternal society, order, or association

operating under the lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals.
* * *"

II

The novelty and importance of the question involved requires an early authoritative decision of this Court.

This Court has never passed upon the question of whether, in computing the federal estate tax, the amount of a deduction for a charitable bequest must be reduced by a sum equivalent to the amount paid, or agreed to be paid, by the charitable beneficiary to a contestant of the will in settlement of the contest. The statute is silent. It apparently was assumed, prior to the decision of this Court in *Lyeth* v. *Hoey, supra,* that amounts so paid were taxable to the recipient under the income tax law. That case, holding such amounts not to be taxable income, has resulted in an effort by the taxing authorities to treat such amounts, regardless of the source and manner of payment, as subject to estate tax. The question has been before the Commissioner on numerous occasions.

Prior to the decision below in the instant case, one Circuit Court of Appeals had held, in the only appellate decision on the question (*Robbins* v. *Commissioner, supra*), that the principles of the *Lyeth Case* had no application to estate tax situations. Our case came next. The court below, in reality, took the view that, since the amount paid the contesting widow was not subject to income tax, it must be subject to estate tax and ignored the reasoning

of the *Robbins Case* in favor of that in the *Lyeth Case*. The *Thompson Case, supra,* just decided by the Second Circuit rests upon our case, and certiorari will be sought there.

To reach the result which it did, the court below had to fly in the face of the established rules laid down by this Court that the estate tax is one on transmission and is to be determined by what the testator did as of the date of his death (See III, *infra*). It had to conflict with the reasoning of the *Robbins Case* (See IV, *infra*) and it clearly misapplied the principles of the *Lyeth Case* (See V, *infra*). It was required to stretch the plain language of the applicable statutory section beyond all basis (See VI, *infra*) and thereby invaded the Congressional field of legislation, since the statute does not contemplate the situation here (See VII, *infra*).

We thus have a conclusion, in the instant case, which is not only unsoundly and illogically reached, but which is plainly wrong, giving rise to unjust and impractical results, as will be pointed out. The law on the subject is not only uncertain now, but abounds in possibilities of injustice and confusion in the future. The situation involved is not an uncommon one and testators and their executors are entitled to an authoritative ruling by this Court.

III

The decision of the lower court is in fundamental contravention of the rules laid down by this Court that the situation created by the will of the testator is controlling as to deductions for estate tax purposes, unless otherwise provided by statute.

It is fundamentally established by a long line of decisions

of this Court that the federal estate tax is one on transmission and not on succession. *Knowlton* v. *Moore,* 178 U. S. 41, 48, 49. The law taxes not the interest to which the legatees and devisees succeeded on death, but the interest which ceased by reason of death. It is a levy on the act of the testator, not on the receipt of property by the legatee, coming into existence before, and independent of, the receipt of the property by the legatee. *Y. M. C. A.* v. *Davis,* 264 U. S. 47; *Edwards* v. *Slocum,* 264 U. S. 61; *New York Trust Company* v. *Eisner,* 256 U. S. 345, 348, 349. Consequently, it is the will of the testator and the situation existing at the time of his death which governs. Generally speaking, the right to a deduction depends alone upon what the testator did. *Y. M. C. A.* v. *Davis, supra; United States* v. *Provident Trust Co.,* 291 U. S. 272.

These primary rules relating to the basic nature of this tax and the construction of the applicable statute should constitute the first line of reasoning in the controversy at bar. They must prevail, unless Congress has legislated an exception to them in the particular instance of moneys paid by charitable beneficiaries in settlement of will contests. Obviously, the law contains no such exception. The court in the *Robbins Case* grounded its conclusion on this basis—the status as created by the testator in his will must govern. If he left the residue to charity, such bequest is deductible; if he did not, it is taxable irrespective of happenings subsequent to death.

Our court, in its opinion (R. 79), recognized the rules, but invented a device to attempt to avoid their consequences. It said that since there are events occurring after death which affect the amount of the taxable estate, such as the incurring of administration expenses, there is no reason why payments made by a charity to a contestant cannot fall in the same category. The error is manifest,

for the deductibility of administration expenses is expressly allowed by Sec. 303 (a) (1) of the statute. There is absolutely no mention of the treatment of payments to a will contestant. To allow such an invention to stand without legislative basis, is to open wide the door to deviations from the fundamental theory of this tax, contrary to the expressed intent of Congress.

IV

The decision of the lower court is in conflict with the reasoning of *Robbins* v. *Commissioner* in the First Circuit Court of Appeals.

As has been indicated, the first appellate decision involving this question was *Robbins* v. *Commissioner, supra,* in the First Circuit. There Amherst College was a contingent legatee in remainder. A next-of-kin of the testator contested the will. An agreement of settlement of the contest was entered into, to which the college was a party and by which it was to receive a minimum sum certain in the future from the residuary legatee. Thereafter, the executor sought a deduction in estate tax in the amount Amherst was to receive by virtue of the compromise agreement. The Circuit Court affirmed the denial of the claimed deduction.

In its opinion, it gave the sound reason that the deduction could not be allowed, under the fundamental rules discussed in III, *supra,* because the money Amherst was to receive was not given to it under the will of the testator. The Court said:

"Hence, it is clear that whatever rights Am-

herst College has now come to it through the compromise agreement and not under the will of the testator. The compromise agreement is not the will of the testator. *Obviously, to allow a deduction of the gift of* $250,000.00 *to Amherst College, * * * is to allow a deduction not under the will of the testator but under the compromise agreement. This would not be a transfer tax on the property of the decedent at the date of his death. It is not a deduction permissible under this statute.*" (italics ours)

It further held that the principles of *Lyeth* v. *Hoey, supra,* (to be discussed under V, *infra*) had no application to these estate tax situations.

In the court below, petitioners relied upon the reasoning in the *Robbins Case,* believing it to be sound and consonant with the statutory language and the theory of the tax. We think the result of the *Robbins Case* is right and properly spelled out, even though the deduction was disallowed. Our court ignored the reasoning of that case and inferentially disapproved it. To have accepted it, would have required the allowance of petitioners' claim for deduction. It attempted to dispose of the case without mention of the rationale, by involvedly arguing that the First Circuit might have decided it on another basis, consistent with *Lyeth* v. *Hoey, supra,* which would have made the expressed reasoning unnecessary (R. 84). The attempted differentiation is subject to the same fundamental weakness pointed out in III, *supra,* and V, *infra.*

The Second Circuit, in the recent *Thompson Case, supra,* took the same tack in its cursory treatment of the *Robbins* decision, although there is an inferential intimation that there is a difference in the reasoning of the two opinions.

We have, then, a clear conflict in the reasoning of the Circuits. The First Circuit is sound in its approach; the Second and Third Circuits sacrifice principle to insure taxability. This Court should resolve the conflict and dictate the correct approach.

V

The principles of *Lyeth* v. *Hoey* have no application to estate tax situations and the misapplication of the broad language in that decision has resulted in confusion and uncertainty in the law.

The court below based its decision primarily on the principles enunciated by this Court in *Lyeth* v. *Hoey, supra.* The Second Circuit, in the *Thompson Case,* applied the same reasoning, although conceding that there may be areas of gap and overlap in the field of federal taxation. The First Circuit, in the *Robbins Case,* said that the reasoning of the *Lyeth Case* did not apply in estate tax situations.

Let us consider the *Lyeth Case.* A testator bequeathed her residuary estate to a charity. Certain of her heirs contested the will. A settlement agreement was entered into, which, in substance, divided the residue between the heirs and the charity. The probate court decreed that the executors were to administer the estate in accordance with the will and the agreement. The question arose as to whether one of the heirs was liable for income tax on the amount he received under the compromise agreement. Involved only was the interpretation of Sec. 22 (b) (3) of the Revenue Act of 1932, which exempts from income tax "The value of property acquired by gift, bequest, devise or inheritance * * *". This Court reasoned that the heir obtained what he received under the agreement "be-

cause of his standing as an heir and of his claim in that capacity". It was concluded that the amount so received was, consequently, an "inheritance" within the meaning of that word as used in the above section.

Our court adopted this reasoning *in toto*—"what the widow received in settlement of the will contest, she took by 'inheritance' within the meaning of the Revenue Acts." (R. 84). The court, at the same time, admitted that she took in spite of the will—not because of it and not under the intestate law. We thus have, in the first place, the creation of a novel category of succession denominated "inheritance", hitherto unknown to the applicable law. Secondly, and more important, this word "inheritance" is not found in Sec. 303 (a) (3), or any other applicable section of the estate tax law, as it is in the income tax law. The theories of the two taxes are vitally different. As the First Circuit said in the *Robbins Case*, in discussing *Lyeth* v. *Hoey*:

> "It would not follow from this, however, that the gift which Amherst received under the compromise agreement should itself be regarded as the gift of the testator and a 'bequest' within the meaning of Section 303 (a) (3). The purposes of the two sections of the Revenue Act are not identical. As we have pointed out, the estate tax is based upon the value of the interest which ceased at the time of the testator's death."

While we do not quarrel with the result of the *Lyeth Case*, we do say that, no matter how broad the language of the opinion, its reasoning, in the interpretation of a word in one statute, cannot be applied automatically to another piece of legislation where the same word does

not appear and where the theory and problem involved are quite different, despite superficial similarities of fact.

The test of the applicability of the language of the *Lyeth Case* lies in its extremities. In New Jersey, the widow has no statutory right of election against a will, except as to dower in real property (not involved in the case at bar). She may be validly cut off without a penny. See *Schaefer* v. *Gessler,* 121 N. J. Eq. 42, 44, 188 Atl. 439. Her standing to contest, like that of any other next-of-kin, may well be without substantial foundation and constitute nothing more than a nuisance. Frequently, a charitable beneficiary will settle such claims only to avoid the expense of protracted litigation, to speed administration and to safeguard against the long chance that, if the contestant should win and the entire will is thus voided, it will take nothing. Suppose the contestant was a purported common-law wife, or an alleged illegitimate child, or an impostor, with no real facts to support the alleged relationship, or a stranger in blood who was mentioned in a prior will. A settlement of such caveats is frequent in order to be rid of the contestant with the least possible notoriety and expense. There may be a right to file a caveat, but certainly no basis of "inheritance", in the event of settlement. These situations all demonstrate that the rights of a contestant arising from a settlement agreement arise not under the will or by intestacy, but by contract, and that there is no such thing as succession by "inheritance" in such cases.

Moreover, such results being contractual between the contestant and the charitable beneficiary, the executors, as in the case at bar, are not usually parties to the agreement. An executor may not even know of such agreements. It is imposing a very heavy burden of responsibility to visit upon him the tax consequences of such "deals",

which may well be consummated privately and long after his duties of administration have terminated and the estate distributed. In addition, in this case, the probate court decreed that the entire residue should be paid to the charity (R. 77). The latter gave a refunding bond and release to petitioners in that amount, as required by New Jersey law. Revised Statutes of New Jersey 1937, Sec. 3:26-19 and 20. The widow, under the agreement, was a complete stranger to them; she could not be compelled to refund a cent if additional debts were subsequently established.

Furthermore, this theory of taking by "inheritance" would require the gross estate, for estate tax purposes, to be established as of the date of death, but the net estate to be determined by events transpiring long thereafter. Congress never intended any such result by the language it used in Sec. 303 (a) (3).

It is obvious that the principles and language of *Lyeth* v. *Hoey* cannot stand the test of application to estate tax cases. The attempt so to do in the instant case is a misapplication, resulting in confusion and uncertainty in the law.

VI

The court below erred in construing Sec. 303 (a) (3) to mean that a charitable bequest is deductible only to the extent actually used for charitable purposes.

As a secondary reason for its conclusion, the court below said that this statutory section must be read to mean that a charitable bequest is deductible only to the extent that the charity receives and uses it for charitable purposes. In support of this view, the court pointed to language in the statute which exempts bequests to trustees or

lodges, as distinct from charitable corporations, if such gifts "are to be used" by such trustees or lodges exclusively for charitable purposes.

This point of construction has never been passed upon by this Court. The section does not purport to impose the alleged limitation of deductibility where the legatee is a charitable corporation. The effect of the lower court's view is to impose a stricter rule in the case of trustees or lodges—certainly an odd result.

The reason why the section contains this so-called limitation in the case of trustees and lodges is apparent. Not being essentially charities, Congress had to be sure that, from the language of the will, the testator intended his bequest to such a trustee or lodge, *ab initio,* "to be used" for charitable uses only, as in the instant case. We submit that the statutory language relates to the terms of the will and not to events subsequent to death. The two types of charitable bequest mentioned in the statute are thereby put upon an equal basis. To carry the thought of the court below to its logical conclusion would mean that a bequest to a charitable corporation, to be deductible, need not be used for charitable purposes. Such a differentiation is absurd and could never have been intended by Congress.

Assuming an equal footing in the law for both types of charitable bequest, we come to the general construction placed thereon by our court that deductibility must be measured by the actual number of dollars ultimately used for charitable purposes. To be logical, this rule must be applied not only in situations where the charitable beneficiary pays moneys in settlement of a will contest, but also in every other case, to the extent that every dollar received will have to be traced to be certain that it is spent only for charitable purposes. For example, the deduction would have to be reduced by the amount a charity paid its at-

torneys to represent it in the estate proceedings. Moreover, this rule would produce inequitable and impractical results. What would happen, tax wise, if a charitable devisee of land were to make a compromise settlement by the payment of money, no part of which had been received under the will, at the same time retaining the land? Suppose a charitable beneficiary settled a contest by agreeing to pay a specific sum which turned out to be in excess of the amount it ultimately received under its legacy. How would the estate tax be computed in such a situation if this rule is to be the law? To pose the question is to demonstrate the danger.

Again we say, the statute is barren of any language which can reasonably give rise to such a conclusion. Congress has simply not so said. The court below has just gone too far. Its attempted reliance on Art. 47 of Treasury Regulation 80 is of no help for that article obviously relates to charitable bequests made conditional by the terms of the will itself.

The practical reason why the statutory section goes no further than it does is a sound one. While the deriving of revenue is important, there must be some date at which further inquiry is cut off in order that estates may be seasonably administered and closed. Were the lower court's rule to be adopted, a charitable bequest would have to be followed by executors indefinitely to insure against a nondeductible diversion. Congress, therefore, has seen fit, by not saying more than it did, to limit the taxable basis in these situations to the will of the testator as of the date of his death, in line with the general theory of the estate tax.

VII

The court below invaded the Congressional field of legislation.

Petitioners submit that the controversy in the case at bar boils down to a situation in which the Second and Third Circuits have construed the language of Sec. 303 (a) (3) beyond any reasonable basis and have attempted, by judicial fiat, to plug a gap left by Congress in the statute. No matter how desirable it may be to subject moneys received from charitable beneficiaries in settlement of a will contest to some form of tax, it is beyond the province of the courts to legislate on the subject by reading something into the estate tax law which is not there. The remedy is with Congress.

The Second Circuit in the *Thompson Case* sensed the difficulty, although still taking the expedient course. That court adverted to the situation in this language:

> "While there are no doubt areas both of gap and of overlap in the field of federal taxation, we cannot lightly assume that the contestants take 'by inheritance', so as to be free from income tax, the very same amounts which the charities receive as 'legacies' so as to permit an estate tax deduction."

Under all of the circumstances, the elementary principle must be applied that a tax statute is to be construed liberally in favor of the taxpayer. *Bowers* v. *New York & Albany Co.*, 273 U. S. 346, 350. This rudiment is specifically applicable to provisions concerning the exemption from tax of bequests to charity. *Beggs* v. *United States*, 27 Fed. Supp. 599, 606.

For the foregoing reasons, a writ of certiorari should be granted.

Dated: November 24, 1941.

Respectfully submitted,
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APPENDIX A

Revised Statutes 1937, Sec. 3: 26-19

3: 26-19. Refunding bond of legatee or distributee; executor or administrator to take

An executor or administrator shall, on paying a legacy or distributive share to the person entitled, take a refunding bond therefor, to be filed in the office of the surrogate of the county wherein he received his letters or in the office of the register of the prerogative court, if he received his letters from the ordinary.

Revised Statutes 1937, Sec. 3: 26-20

3: 26-20. Amount and form of bond

The bond required under section 3:26-19 or section 3:26-27 of this title shall be in double the amount or value of the legacy or allotted distributive share and shall be sufficient, if signed by the legatee or distributee, or his guardian, as the case may be, without any sureties whatever.

The bond of a legatee shall be conditioned substantially as follows: That if any part of the whole of such legacy shall at any time thereafter appear to be wanting to discharge any debt or debts, legacy or legacies, which the said executor or administrator may not have other assets to pay, he, the said legatee, will return his said legacy or such part thereof as may be necessary for the payment of the said debts, or for the payment of a proportional part of the said legacies.

The bond of a distributee shall be conditioned sub-

stantially as follows: That if any debt or debts, truly owing by the intestate, shall be afterwards sued for and recovered or otherwise duly made to appear, and which there shall be no other assets to pay, he shall refund and pay back to the administrator his ratable part of such debt or debts, out of the part and share so allotted to him.

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 760

ESTATE OF JOHN SAGE, DECEASED, ALFRED D. SAGE, ROBERT J. RENDALL AND THE FIFTH AVENUE BANK OF NEW YORK, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 33–39) [1] is reported in 42 B. T. A. 1304. The opinion of the Circuit Court of Appeals (R. 79–87) is reported in 122 F. (2d) 480.

[1] Since the record has not been separately printed, the record references are to those portions of the record appearing in the appendix to the petitioner's brief in the Circuit Court of Appeals.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 27, 1941 (R. 87–88). On September 18, 1941, an order was entered extending the time within which petition for a writ of certiorari might be filed for a period of sixty days from September 27, 1941. The petition for a writ of certiorari was filed November 25, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the deduction allowable for a residuary bequest to charity under Section 303 (a) (3) of the Revenue Act of 1926, as amended, should be reduced by the amount payable to the decedent's widow by the residuary legatee under a compromise agreement between the widow's guardians and the legatee.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 9–11.

STATEMENT

The Board adopted the stipulated facts as its findings, which are as follows (R. 34–36):

John Sage, a resident of Bergen County, New Jersey, died testate on October 11, 1936. He left a widow who was adjudged an incompetent on December 21, 1936. Her brother, John Tonnessen,

and her sister, Sadie Weiss, were appointed guardians by the Bergen County Orphans' Court and they continued to act in that capacity until discharged on March 22, 1938 (R. 34).

The decedent left an estate of approximately $450,000. To his widow, he bequeathed his household effects and legacies totaling $42,000. The residuary estate was bequeathed to the Lord Provost of Glasgow, Scotland, to be devoted to the care and maintenance of the disabled soldiers and sailors of the British Army and Navy according to his best judgment (R. 34).

The decedent's will was first offered for probate in a Surrogate's Court in New York but on the objections[1] of the widow's guardians the proceedings were dismissed and the Surrogate ordered the will to be sent to Bergen County, New Jersey (R. 34–35), where it was offered for probate on or about April 9, 1937.

On May 8, 1937, John Tonnessen and Sadie Weiss, as the guardians of the decedent's widow, entered into an agreement with the Lord Provost of Glasgow, Scotland, through his attorney in fact, Thomas A. S. Beattie, which provided that the widow's guardians would consent to the probate of decedent's will as a competent instrument to pass his real and personal property and that the Lord Provost would pay to decedent's widow a

[1] The objections were to the probate of the instrument as the last will and testament of the decedent (R. 37).

sum equivalent to 25 percent of the amount received by him under the provisions of decedent's will. The executors were not parties to this agreement and it was not incorporated in or made a part of the probate proceedings (R. 35). Upon the petition of the guardians of the widow, however, it was approved by the order of the Bergen County Orphans' Court.

Decedent's will was admitted to probate on May 19, 1937. On the same day letters testamentary were issued to the executors, who immediately thereafter undertook administration of the estate. On or about December 1, 1937, the executors filed their final account with the Bergen County Orphans' Court and on January 11, 1938, the court made a decree allowing the account. The decree showed a balance of $175,750.48, after payment of specific and general legacies and allowances, and payment of all commissions, counsel fees, and other disbursements. Thereafter, the executors filed a petition with the Orphans' Court praying for a decree of distribution and such decree was entered on February 9, 1938. It directed that the entire balance on hand be paid to the Lord Provost of Glasgow, Scotland, as residuary legatee. Neither this decree nor that allowing the account provided for any payment or payments to decedent's widow or her guardians (R. 35–36).

The State of New Jersey assessed transfer inheritance taxes upon the entire residuary estate

as a charitable and public bequest, pursuant to the statutes and decisions of that state, and no part or portion thereof was taxed to decedent's widow (R. 36).

In the federal estate tax return the executors claimed a deduction for the full amount of the residuary estate, as a charitable and public bequest. On or about January 5, 1939, in determining the deficiency, the Commissioner disallowed one-fourth of the claimed deduction on the theory that under the terms of the agreement the amount payable by the Lord Provost to the widow passed from the decedent to the widow and not from the Lord Provost to the widow. The Commissioner determined a deficiency in the sum of $9,687.66 (R. 36).

The Board of Tax Appeals approved the Commissioner's determination (R. 40).

The Circuit Court of Appeals affirmed the Board's decision (R. 87–88).

ARGUMENT

1. The question raised in this case is settled by *Lyeth* v. *Hoey,* 305 U. S. 188. In that case the Court held that the property received by the taxpayer from the estate of his deceased grandmother in compromise of his claim as heir was received by inheritance and so was not subject to income tax. The Court also indicated that the term "inheritance" should be given the same meaning for estate tax purposes as for income tax. 305 U. S. at 194–195. It follows that here the decedent's

widow took by inheritance the amount paid her under the compromise agreement. Necessarily, therefore, that same amount did not pass by inheritance to the charity and was rightly excluded from the deduction.

2. There is no conflict among the circuits; the only courts which have considered the question have reached the same conclusion as the court below. See *Thompson* v. *Commissioner* (C. C. A. 2d), decided November 17, 1941, not yet officially reported, and *Heim* v. *Nee* (W. D. Mo.), decided May 28, 1937, not officially reported, but found in 19 A. F. T. R. 1318, or 1937 C. C. H., Vol. 4, 9371.

It is true that in *Robbins* v. *Commissioner,* 111 F. (2d) 828 (C. C. A. 1st), the court declined to give any weight to a compromise agreement, but that case does not conflict with the decision below. There, an heir had contested the will and a compromise agreement was substituted giving the charity a specific remainder interest in lieu of its designation under the will as beneficiary under a power of appointment. The only issue was whether the original want of certainty that a gift in any but a nominal amount would be made to the charity, could be supplied after death by the compromise settlement so as to permit a deduction for a charitable bequest. No question was presented as to the manner in which a contestant succeeds to the consideration paid him or of the effect of the pay-

ment in measuring what is inherited by the beneficiary who made the payment.

There is a second difference between the *Robbins* case and the decision below. In the present case the bequest was to a trustee. But Section 303 (a) (3) of the Revenue Act of 1926, as amended (Appendix, *infra,* p. 10), permits a deduction—

> * * * only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, *exclusively* for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. * * * [Italics supplied.]

Since the Lord Provost was obligated prior to the receipt of the legacy to turn over 25% to the widow, it is clear that he could not use it exclusively for religious, charitable, etc., purposes, and that a deduction in the full amount of the legacy would therefore be improper.

3. Our position is not contrary to the well established rule that the estate tax is imposed on the interest which ceases at death. While the date of death is determinative for certain purposes, there are others for which subsequent events must be taken into account. For example the computation of the net estate depends in part on items unknown at death, such as funeral expenses, and administration costs. Similarly, it cannot then be known

whether the will will be admitted to probate or what charitable bequests will pass thereunder. By the time the will is admitted to probate, it may happen, as in the instant case, that interested parties have made an agreement which in effect modifies the will and actually decreases the amount which the charity receives and retains for its own uses. Obviously by entering into such an agreement, the parties cannot acquire a status not recognized by the state law or the will at the date of the decedent's death but they can shift the amounts to be paid to various legatees. If additional sums are paid to one who has standing as an heir, they go to him by inheritance and should be a part of the decedent's net estate even though they come out of a portion which might otherwise have gone to charity.

CONCLUSION

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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DECEMBER 1941.

APPENDIX

Revenue Act of 1926, c. 27, 44 Stat. 9:

SEC. 301. (a) In lieu of the tax imposed by Title III of the Revenue Act of 1924, a tax equal to the sum of the following percentages of the value of the net estate (determined as provided in section 303) is hereby imposed upon the transfer of the net estate of every decedent dying after the enactment of this act, whether a resident or nonresident of the United States;

* * * * *

(U. S. C., Title 26, Sec. 410.)

SEC. 303. For the purpose of the tax the value of the net estate shall be determined—

(a) In the case of a resident, by deducting from the value of the gross estate—

* * * * *

(3) The amount of all bequests, legacies, devises, or transfers, to or for the use of the United States, any State, Territory, any political subdivision thereof, or the District of Columbia, for exclusively public purposes, or to or for the use of any corporation organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, including the encouragement of art and the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private stockholder or individual, or to a trustee or trustees, or a fraternal society, order, or association operating under the

lodge system, but only if such contributions or gifts are to be used by such trustee or trustees, or by such fraternal society, order, or association, exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals. The amount of the deduction under this paragraph for any transfer shall not exceed the value of the transferred property required to be included in the gross estate; and

* * * * *

(U. S. C., Title 26, Sec. 412.)

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 807. DEDUCTIONS ON BEQUESTS, ETC., TO CHARITY.

Sections 303 (a) (3) and 303 (b) (3) of the Revenue Act of 1926 are amended by inserting after the first sentence of each a new sentence to read as follows:

"If the tax imposed by section 301, or any estate, succession, legacy, or inheritance taxes, are, either by the terms of the will, by the law of the jurisdiction under which the estate is administered, or by the law of the jurisdiction imposing the particular tax, payable in whole or in part out of the bequests, legacies, or devises otherwise deductible under this paragraph, then the amount deductible under this paragraph shall be the amount of such bequests, legacies, or devises reduced by the amount of such taxes."

(U. S. C., Title 26, Sec. 412.)

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 403. CITIZENSHIP AND RESIDENCE OF DECEDENTS.

(a) Section 303 (a) of the Revenue Act of 1926, as amended, is amended by striking

out "In the case of a resident" and inserting in lieu thereof "In the case of a citizen or resident of the United States."

* * * * *

(U. S. C., Title 26, Sec. 412.)

SEC. 406. NONDEDUCTIBILITY OF CERTAIN TRANSFERS.

Section 303 (a) (3) and section 303 (b) (3) of the Revenue Act of 1926, as amended, are amended by inserting after "individual", wherever appearing therein, a comma and the following: "and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation".

(U. S. C., Title 26, Sec. 461.)

U. S. GOVERNMENT PRINTING OFFICE: 1941